Supreme Court, U.S.
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IN THE OFFICE OF THE CLERK

Supreme Court of the United States

RICHARD A. QUINN and SCOTT W. TUCKER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

HILAREE A. CASADA
Counsel of Record
JULIA F. PENDERY
GODWIN GRUBER, LLP
Renaissance Tower
1201 Elm Street
Suite 1700
Dallas, Texas 75270
(214) 939-4400

Attorneys for Petitioners

188825

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

QUESTION PRESENTED

May a district court order a wrongdoer in a securities fraud case to disgorge all business proceeds, rather than just the profits received as a result of the fraudulent activity?

LIST OF PARTIES

United Energy Partners, Inc., a defendant below, is being served as a respondent.

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Richard A. Quinn and Scott W. Tucker, Petitioners, respectfully pray that a writ of certiorari issue to review the opinion and order of the United States Court of Appeals for the Fifth Circuit entered in this case on February 18, 2004 and May 3, 2004, respectively, which affirmed the district court's June 5, 2002 partial summary judgment order and the district court's January 18, 2003 memorandum opinion and order.

OPINIONS BELOW

The district court's June 5, 2002 partial summary judgment order is unpublished and is included as Appendix C hereto. The district court's January 18, 2003 memorandum opinion and order is unpublished and can be found at *SEC v. United Energy Partners, et al.*, 3:98-CV-0218-R, 2003 U.S. Dist. LEXIS 1247, Fed. Sec. L. Rep. (CCH) P92,441 (N.D. Tex. January 18, 2003), and is included as Appendix B hereto. The opinion of the Fifth Circuit Court of Appeals is reported at *SEC v. United Energy Partners, et al.*, 88 Fed. Appx. 744, 2004 U.S. App. LEXIS 2835, Fed. Sec. L. Rep. (CCH) P92,690 (5th Cir. February 18, 2004), and is included as Appendix A hereto. The order of the Fifth Circuit denying the petition for rehearing in this case is unpublished and is included as Appendix D hereto.

JURISDICTION

The Fifth Circuit Court of Appeals' opinion, which is the judgment sought to be reviewed, was entered on February 18, 2004. The Fifth Circuit denied Petitioners' timely-filed Petition for Rehearing on May 3, 2004.

Jurisdiction in the Supreme Court is established by 28 U.S.C. § 1254(1).

RELEVANT STATUTES

Although the underlying litigation involved the alleged violation of various federal securities laws, the issues raised in this Petition do not relate to those statutes or to any constitutional provisions, treaties, ordinances, or regulations.

STATEMENT OF THE CASE

A. Nature of the Case

In 1998, the Securities and Exchange Commission ("the Commission") sought injunctive relief against United Energy Partners, Inc. ("United Energy"), Richard A. Quinn ("Quinn"), and Scott W. Tucker ("Tucker"). The Commission contended that Quinn and Tucker had violated the antifraud provisions of the following statutes by knowingly making false and misleading statements in the course of selling securities: (1) Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a); (2) Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78(j)b; and (3) Rule 10b-5. The Commission sought disgorgement, civil penalties, and a permanent injunction against Quinn and Tucker. Thereafter, the Commission filed a motion for partial summary judgment.

The district court granted partial summary judgment and later final judgment in favor of the Commission. The district court ordered Quinn and Tucker to disgorge $7.5 million jointly and severally, together with prejudgment interest and post-judgment interest. On a consolidated appeal to the Fifth Circuit, in which the court had jurisdiction based on 28 U.S.C. § 1291, the Fifth Circuit affirmed the district court's judgment. The Fifth Circuit denied a timely filed petition for rehearing. This petition followed.

B. Statement of Facts

United Energy was an oil and gas company, that since 1994, had relied on investors to fund its lease acquisition and exploration activities and had drilled and completed sixteen oil and/or gas wells in ten separate joint ventures. Quinn, chief executive officer and ninety percent shareholder of United Energy, was responsible for the activities of United Energy and directly offered and sold undivided working interests in the oil and gas wells to investors. Tucker, executive vice president and ten percent shareholder, also directly offered and sold undivided working interests in the wells. Both sold working interests in the wells to at least 285 investors, raising approximately $7.5 million in proceeds. Quinn received $445,328.08 and Tucker received $270,508.26 from their actual employment with the company.

On January 30, 1998, the Commission filed a civil action against United Energy, Quinn, and Tucker, alleging that they had violated the antifraud prohibitions of the Securities Act and the Exchange Act, and that Tucker had separately violated the broker registration provisions of the Exchange Act. In August 1998, the district court appointed a Special Master. Thereafter, Quinn and Tucker returned all of their assets to the Special Master and surrendered their interest in United Energy.

In its June 5, 2002 order, the district court granted partial summary judgment for the Commission on its claims against Quinn and Tucker, ordered them to disgorge $7.5 million jointly and severally, awarded pre-judgment interest, and enjoined Quinn and Tucker from committing future violations. The district court later imposed a $110,000 civil penalty against each party. The court entered final judgment on March 3, 2003.

Quinn and Tucker filed a notice of appeal with the Fifth Circuit challenging the partial summary judgment and later appealed the final judgment. Those appeals were consolidated, and the Fifth Circuit affirmed the district court's orders.

REASONS FOR GRANTING THE PETITION

I. The Fifth Circuit's affirmance of the district court's $7.5 million disgorgement order contradicts the Fifth Circuit's own precedent and conflicts with a majority of the other Circuits that have addressed this question.

The district court ordered the Petitioners to disgorge $7.5 million, which corresponded to the amount the Commission contended United Energy had raised from investors between June 1995 and January 1998. In affirming that decision, the Fifth Circuit held that $7.5 million was "a reasonable estimate of the profits received by fraud." This amount, however, represents the entirety of the *proceeds* obtained by United Energy, not the *profits* Petitioners received from their involvement with United Energy. The district court's own findings show that Quinn received no more than $445,328 and Tucker no more than $279,508 from their employment with United Energy, in addition to already surrendered overrides on United Energy-sponsored wells and the $81,000 United Energy spent in 1996 for Quinn's personal benefit. Those were the only "profits" Petitioners could have possibly obtained, and, therefore, the disgorgement order entered by the district court should not have exceeded these amounts. Moreover, Petitioners had previously surrendered all gains, ill-gotten or otherwise, that they had obtained from United Energy's activities to the Special Master. As such, the entire disgorgement award amounts to an improper penalty.

A. A party is only required to disgorge its profits resulting from the fraudulent activity.

Although the decision to order disgorgement is equitable in nature, the method of calculation is not. The law is settled that a party is only required to disgorge its *profits* resulting from a fraud. *See Commodity Futures Trading Comm'n v. Sidoti*, 178 F.3d 1132, 1138 (11th Cir. 1999) (noting that a district court may not disgorge profits obtained without the aid of any wrongdoing)[1]; *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995) (stating that "disgorgement need only be a reasonable approximation of the profits causally connected to the violation"); *SEC v. Bilzerian*, 29 F.3d 689 ,697 (D.C. Cir. 1994) (upholding the district court's order reasonably approximating illicit profits); *Commodity Futures Trading Comm'n v. Am. Metals Exch. Corp.*, 991 F.2d 71, 77 n.10 (3d Cir. 1992) (holding that a trial court abused its discretion by not holding a hearing to determine the amount of illegal profits); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (holding that the district court had the equitable power to order a party to disgorge only those amounts with interest by which the party profited from his wrongdoing).

In *Blatt*, the Fifth Circuit unequivocally stated that disgorgement is not punitive. *Blatt*, 583 F.2d at 1335. The court further held that a court's disgorgement power "extends only to the amount with interest by which the

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1. Cases involving the Commodity Exchange Act have followed the rationale supporting disgorgement in actions under the securities laws—that allowing a violator to retain the profits from his violation would frustrate the purposes of the regulatory scheme. *Id.* at n.9. Thus, the law applied in cases involving the Commodity Futures Trading Commission also applies to cases where the Securities Exchange Commission is a party.

defendant profited from his wrongdoing." *Id.* In that case, the district court properly ordered the defendant to disgorge his $315,000 in profits. *Id.* at 1335-36. The term "profit," being undefined by the Securities Exchange Act, must be assumed to have its ordinary or usual meaning: the excess of revenues over expenditures in a business transaction. *Heli-Coil Corp. v. Webster*, 352 F.2d 156, 168 (3d Cir. 1965); BLACK'S LAW DICTIONARY 1226 (7th ed. 1999).

Here, the Fifth Circuit seemingly disregarded this well-established precedent and affirmed a disgorgement award that far exceeded the amount the evidence showed as Petitioners' profits from the alleged wrongdoing. The Fifth Circuit justified that error by holding that the $7.5 million "is a reasonable estimate of the profits received by fraud." The summary judgment evidence showed, and the district court found, however, that the profits realized by Petitioners did not exceed $796,000. Thus, the district court's own findings show that the $7.5 million is not even close to a "reasonable approximation" of the purported ill-gotten gains received by Quinn and Tucker. The district court simply disregarded its own findings as to the amounts Quinn and Tucker actually received as profits from their activities with United Energy and instead improperly used the total (and disputed) proceeds received from United Energy's fund-raising activities. This is a clear misapplication of not only Fifth Circuit precedent, but also well-established precedent from a majority of the circuits that have addressed this issue. A writ of certiorari is necessary in this case to correct the conflict created by these decisions and to ensure that Petitioners are not improperly forced to endure a punitive disgorgement award.

B. Legitimate business expenses should offset the disgorgement amount.

The Fifth Circuit also improperly refused to offset the disgorgement amount with legitimate business expenses. As noted *supra*, a disgorgement award should not exceed the profits actually gained by the wrongdoer. Here, the district court's disgorgement order far exceeds the profits realized by Petitioners and fails to take into account the monies used by United Energy for legitimate business expenses.

Disgorgement awards may be off-set by legitimate business expenses in furtherance of the participants' investment objectives. *SEC v. Thomas James Assocs., Inc.*, 738 F. Supp. 88, 92-93 (W.D.N.Y. 1990); *SEC v. Galaxy Foods, Inc.*, 417 F. Supp. 1225, 1249-50 (E.D.N.Y. 1976). The Fifth Circuit's statement that "the overwhelming weight of authority holds that securities law violators may not offset their disgorgement liability with business expenses" overstates the state of the law and relies on cases that are distinguishable from the case at bar. Although the district courts in the District of Columbia and the Eastern District of Michigan have held that legitimate business expenses do not have to be used to off-set a disgorgement amount, those cases involve situations where the business expenses were expended to further the fraud. *See SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 16 (D.D.C. 1998) (stating that a party who obtains funds fraudulently may not escape disgorgement by asserting that expenses associated with the fraud were legitimate); *SEC v. Great Lakes Equities Co.*, 775 F. Supp. 211, 214 (E.D. Mich. 1991), *aff'd without opinion*, 12 F.3d 214 (6th Cir. 1993) (holding that deductions for overhead were not warranted since the manner in which the defendants chose to spend their misappropriation was irrelevant to their

objection to disgorgement). Where, as here, the business expenses were used to further legitimate business goals, rather than the fraud, those expenses may be applied to offset the disgorgement amount. *See SEC v. Bocchino*, 2002 U.S. Dist. LEXIS 22047, *7 (S.D.N.Y. 2002) (holding that a court may deduct expenses incurred while garnering the illegal profits, including correspondence and related expenses and transaction costs); *see also SEC v. Thomas James Assocs., Inc.*, 738 F. Supp. 88, 92-93 (W.D.N.Y. 1990); *SEC v. Galaxy Foods, Inc.*, 417 F. Supp. 1225, 1249-50 (E.D.N.Y. 1976).

Here, the district court found that at least half of the aggregate subscription proceeds were devoted to drilling expenses. (Finding No. 38). Those expenditures were earmarked and used for the very purposes promised to the investors—drilling and completing oil and gas wells. Those funds, therefore, furthered the participants' investment objectives and should offset the disgorgement amount. The purpose of disgorgement is to force a defendant to give up the amount by which he was unjustly enriched and deprive him of his ill-gotten gain. Denying offset for legitimate business expenses frustrates this purpose and unfairly penalizes the defendant. The amount of business expenses used in the daily operations of a business are not amounts or profits by which a defendant would be unjustly enriched. These types of expenses would occur regardless of whether a party was committing some type of fraud.

The disgorgement order overlooks the purpose of disgorgement and results in a punitive award against Petitioners that, when combined with the $110,000 civil penalty assessed against each Petitioner, results in an excessive and improper penalty. It also denies Petitioners

offsets that were earned without any fraudulent activity. Such an outcome cannot stand, especially in situations, such as this, where Petitioners have surrendered all of their assets and have then been ordered to disgorge proceeds above any profits earned.

C. Disgorgement of all proceeds, rather than profits, is a penalty that conflicts with the goal and purpose of disgorgement.

The primary purpose of disgorgement is to "deprive the wrongdoer of his ill-gotten gain." *Blatt*, 583 F.2d at 1335. Requiring payment of any further sum, therefore, constitutes an improper penalty assessment. *Id.*; *see also SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972). The disgorgement order in this case is an improper penalty.

Here, the district court found that Quinn received $445,328 in addition to the previously surrendered overrides and payment of personal expenses from his employment with United Energy, and that Tucker received $270,508 in addition to the previously surrendered overrides and payment of personal trip expenses. Yet, instead of ordering disgorgement of those amounts, the district court ordered disgorgement of all the money raised by United Energy from the investors during Petitioners' employment. This award is, thus, nothing more than a penalty that thwarts the purpose of disgorgement.

Moreover, Petitioners have already surrendered all of their assets to the Special Master. By surrendering those assets, Petitioners have given up all gains obtained from United Energy's activities. The $7.5 million, therefore, amounts to additional disgorgement above the amount of actual gains and requires Petitioners to pay monies obtained

lawfully following their employment at United Energy. That amounts to a punitive award that does not comport with the purposes of disgorgement and of the Act.

D. Prejudgment interest is inappropriate under these facts.

The district court's errors in determining a disgorgement amount make its award of prejudgment interest improper. In deciding whether such an award is appropriate and what amounts should be assessed, a district court should consider "the need to fully compensate the wronged party for actual damages suffered; considerations of fairness and the relative equities of the award; the remedial purposes of the statute involved; and/or such other general principles as are deemed relevant by the court." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1477 (2d Cir. 1996), *overruled in part on other grounds*, *Shapiro v. Cantor*, 123 F.3d 717 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997). The theory underpinning an award of prejudgment interest is that a defendant should be prevented from "obtaining the benefit of an interest free loan procured as a result of illegal activity." *SEC v. Sargent*, 329 F.3d 34, 41 (1st Cir. 2003) (internal citation omitted).

Quinn and Tucker did not receive an "interest free loan" of the disgorgement amounts because they gave up everything of value they owned to the Special Master. Their self-imposed penury demonstrates that if they had been unjustly enriched, they were, after their disgorgement, no longer so situated.

Further, the Commission relied on factors set out in *SEC v. First Jersey Securities* as authority for the district court's assessment of prejudgment interest, but curtly dismissed the first factor, "the need to fully compensate the wronged party

for actual damages suffered," as irrelevant. Because the Commission did not establish that it is a victim, it cannot show that there is any need to fully compensate the Commission. This is, however, exactly what the district court did in response to the Commissioner's Motion for Partial Summary Judgment; it set a disgorgement amount equal to the entire amount of money that the Commission claimed investors paid over to United Energy. Indeed, the district court's partial summary judgment order provides no analysis of "the need to compensate the wronged party," and the district court made no finding that anyone was wronged. The district court did not apply the appropriate factors and, therefore, the order of prejudgment interest should be reversed.

Alternatively, should this court determine that the amount of disgorgement should be reduced and that an award of prejudgment interest is appropriate, the amount of prejudgment interest must be recalculated according to the reduced disgorgement amount. *See SEC v. Robinson*, 2002 U.S. Dist. LEXIS 12811, *33 (S.D.N.Y. 2002) (ordering the SEC to recalculate prejudgment interest on the revised disgorgement total).

CONCLUSION

Petitioners Richard A. Quinn and Scott W. Tucker, therefore, respectfully pray that the Court issue a writ of certiorari to review the Fifth Circuit's opinion in this case.

Respectfully submitted,

HILAREE A. CASADA
Counsel of Record
JULIA F. PENDERY
GODWIN GRUBER, LLP
Renaissance Tower
1201 Elm Street
Suite 1700
Dallas, Texas 75270
(214) 939-4400

Attorneys for Petitioners